UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF ILLINOIS

In Re	)	
	)	In Bankruptcy
HENNINGS FEED AND CROP CARE, INC.,	)	Case No. 99-72801
Debtor.	)	
ROGER W. STONE, Trustee,	)	
Plaintiff,	)	
v.	)	Adversary No. 00-7002
DILSAVER & NELSON,	)	
Defendant.	)	

O P I N I O N

This matter is before the Court on the Complaint of Roger W. Stone, Chapter 11 Trustee ("Trustee") to Recover Monies Paid to Defendant Law Firm and the Answer thereto filed by Dilsaver & Nelson ("D&N").

On April 22, 1999, David C. Nelson, a partner in D&N, met for the first time with Marisa Hennings and Larry Hennings, the then chief executive officer of Hennings Feed and Crop Care, Inc. ("Debtor"), regarding Debtor's serious financial problems. Although there was no written retainer or fee agreement entered into between the parties and no retainer was paid at the time, Mr. Nelson commenced representing Debtor at a rate of $150 per hour.

On July 1, 1999, Debtor paid $2,000 to D&N, although by that time, $4,762.50 in fees had been accrued. It is undisputed that

Debtor was insolvent at the time this payment was made.

On or about July 23, 1999, Mr. Nelson and Mr. Hennings had a meeting, during which it was decided that Debtor had no choice but to file bankruptcy. At that time, the parties also decided to retain the services of the law firm of Hopkins & Sutter ("H&S") of Chicago, Illinois, to assist with the bankruptcy filing.

On July 29, 1999, Debtor gave D&N a check for $60,000. Mr. Nelson contends that he told Mr. Hennings that $25,000 of the $60,000 would be retained by D&N for payment of services already rendered and as security for future work to be performed, and the remaining $35,000 would be forwarded by D&N to H&S as H&S's retainer. Mr. Hennings asserts that he understood that D&N intended to pay the entire $60,000 to H&S and that no portion of the $60,000 was to be retained by D&N. In any case, D&N retained $25,000 from the July 29 payment and transmitted the remaining $35,000 to H&S. As of July 29, D&N was owed $9,850 in addition to the $2,000 retainer already paid. It is undisputed that Debtor was insolvent at the time of this transfer.

On August 23, 1999, Debtor filed its voluntary Chapter 11 bankruptcy petition. On September 1, 1999, Trustee was appointed. On January 4, 2000, Trustee filed this adversary complaint seeking the avoidance of the two payments to D&N totaling $27,000 pursuant to Section 547 of the Bankruptcy Code.

D&N originally asserted that it is entitled to retain $25,538.50 of the $27,000 paid to it for legal services it alleges were rendered to Debtor between April 22, 1999, and October 10, 1999. However, at the time of trial, D&N conceded that it was not entitled to be paid for services rendered after September 1, 1999, the date on which the Trustee was appointed.

Trustee contends that D&N should be ordered to disgorge the entire $27,000 because (1) based upon Mr. Hennings' testimony, D&N wrongfully withheld $25,000 as a retainer without the Debtor's knowledge or authorization, and (2) Debtor's payment of said fees constitutes a voidable preference under 11 U.S.C. § 547.

The Court is faced with the conflicting testimony of Mr. Hennings and Mr. Nelson on the question of whether the $25,000 payment to D&N was authorized by Debtor. On July 29, Debtor was in a precarious financial condition and Mr. Nelson knew it well. D&N had rendered services totaling $11,850, had only been paid $2,000, and the parties contemplated that Mr. Nelson would continue to represent Debtor. Under these circumstances, it defies logic for Mr. Nelson to agree to forward the entire $60,000 to H&S without seeking payment for his services. Accordingly, the Court finds Mr. Nelson's testimony considerably more logical and consistent with the facts and circumstances. For this reason, the Court finds that D&N did not wrongfully withhold $25,000 from the $60,000 payment made on July 29.

11 U.S.C. § 547(b), which provides as follows:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property–
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;

(4) made–

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if–

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Both payments to D&N were within ninety days prior to the bankruptcy filing. Therefore, the transfers took place within the preference period. Barnhill v. Johnson, 503 U.S. 393, 112 S.Ct. 1386 (1992). No one disputes, and the record clearly shows, that Debtor was insolvent at the time both transfers were made. The transfers were partially for antecedent debts, i.e., unpaid attorney fees and costs advanced, and partially in the nature of a security retainer. The transfers clearly allowed D&N to receive more than it would have received had the transfers not been made.

D&N argues that, even though all of the elements of § 547(b) may be present, Trustee may not avoid the transfers as preferential because they were in the ordinary course of business.

11 U.S.C. § 547(c)(2) provides as follows:

(c) The trustee may not avoid under this section a transfer--

(2) to the extent that such transfer was–

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms(.)

D&N has the burden of proving the nonavoidability of transfers under this section. 11 U.S.C. § 547(g).

The purpose of the "ordinary course of business" exception is "to leave undisturbed normal financing relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy". H.R. Rep. No. 595, 95th Cong. 1st Sess. 373 (1977); S. Rep. No. 989, 95th Cong. 2d Sess. 88 (1978). As one court explained, "the ordinary course exception to the preference rule is formulated to induce creditors to continue dealing with a distressed debtor so as to kindle its chances of survival without a costly detour through bankruptcy, or a humbling ending in the sticky web of bankruptcy". In re Molded Acoustical Products, Inc., 18 F.3d 217, 219 (3rd Cir. 1994).

11 U.S.C. § 547(c)(2)(B) is a subjective test based upon the course of dealings between the debtor and the transferee. Matter of Garofalo's Finer Foods, Inc., 186 B.R. 414, 428-29 (N.D. Ill. 1995). In determining whether transfers are ordinary in relation to the past practices of the parties, the Court must look at a number of factors, including the following:

1. the length of time the parties were engaged in the transactions at issue;

2. whether the amount or form of tender differed from past

practices;

3. whether the debtor or creditor engaged in any unusual collection or payment activity; and

4. whether the creditor took advantage of the debtor's deteriorating financial condition.

In re Grand Chevrolet, Inc., 25 F.3d 728, 732 (9th Cir. 1994).

The facts in this case demonstrate that the preferential transfers made to D&N in this case are about as far from falling under the "ordinary course of business" exception as one would ever find. First, Debtor's relationship with D&N commenced in April, 1999. Between April, 1999, and the date of filing, Debtor never received a bill from D&N. Yet, in the midst of a hopeless financial picture, and on the eve of (and, admittedly, in contemplation of) bankruptcy, Debtor made the two significant transfers. There is simply nothing in the short course of dealing between the parties to suggest that these payments were made in the ordinary course. The two subject payments are certainly not the customary and routine transactions which the ordinary course exception were meant to protect. Accordingly, this case satisfies neither the letter nor the spirit of the ordinary course exception.

D&N next argues that the payments come within the new value exception of 11 U.S.C. § 547(c)(1), which provides as follows:

> (c) The trustee may not avoid under this section a transfer -
>
> (1) to the extent that such transfer was -
>
> (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtors; and
>
> (B) in fact a substantially contemporaneous exchange(.)

The "contemporaneous exchange for new value" exception is an affirmative defense, and the transferee has the burden of establishing by a preponderance of the evidence that the transfer was intended by the debtor and the creditor to be a contemporaneous exchange for new value given to the debtor and was, in fact, a substantially contemporaneous exchange. In re Jones Truck Lines, Inc., 130 F.3d 323, 326-27 (8th Cir. 1997).

While the legal services provided by D&N may constitute new value as the term is defined in 11 U.S.C. § 547(a)(2), the new value exception of § 547(c)(1) is not applicable to the facts in this case because the transaction did not constitute a contemporaneous exchange, nor did the parties intend for the transfers to constitute a contemporaneous exchange. The transfers were intended by both D&N and Debtor to pay for services rendered before and after the time of the transfer. Accordingly, the new value exception of § 547(c)(1) is not applicable to the facts in this case.

Although it is not raised by either D&N or the Trustee, the Court finds that the "subsequent advance for new value" exception is applicable to the facts in this case. § 547(c)(4) provides as follows:

> (c) The trustee may not avoid under this section a transfer–
>
> (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor–
>
> (A) not secured by an otherwise unavoidable security interest; and
>
> (B) on account of which new value the debtor did not make an otherwise unavoidable

> transfer to or for the benefit of such creditor(.)

Under this provision, a creditor is allowed to set off amounts of postpreference advances that are both unsecured and unpaid on the petition date against amounts that the creditor must return to the Trustee under the preference provision. In re McLaughlin, 183 B.R. 171, 176 (Bankr. W.D. Wis. 1995). The "subsequent advance for new value" exception of § 547(c)(4) is intended to fairly treat creditors who have replenished the estate after having received a preference. Matter of Toyota of Jefferson, Inc., 14 F.3d 1088, 1091 (5th Cir. 1994); In re New York City Shoes, Inc., 880 F.2d 679, 680-81 (3rd Cir. 1989).

In order for a creditor who received a preferential transfer under § 547(b) to take advantage of the "subsequent advance for new value" exception, the creditor must establish the three elements. First, the creditor must have extended new value to the debtor or on the debtor's behalf after receiving the preference. In re Tennessee Valley Steel Corp., 201 B.R. 927, 940 (Bankr. E.D. Tenn. 1996). Second, the new value must not be secured by an otherwise unavoidable security interest. In re Micro Innovations Corp., 185 F.3d 329, 335 (5th Cir. 1999). Third, the new value must remain unpaid after its transfer. In re New York City Shoes, Inc., *supra*, 880 F.2d *at* 680. Subsequent new value may be used to set off against any previous preference until it is exhausted; it is not limited to the single payment immediately preceding the new value. In re IRFM, Inc., 52 F.3d 228, 232 (9th Cir. 1995); In re Meredith Manor, Inc., 902 F.2d 257, 259 (4th Cir. 1990). Postpetition advances do not fall within the new value exception. In re Richards, 92 B.R. 369, 372 (Bankr. N.D. Ind. 1988).

In this case, it is clear that D&N extended new value to Debtor after receiving the preferences. Following receipt of the preferences, D&N continued working for the Debtor as corporate counsel. The services rendered added new value to the estate of Debtor. The work performed by D&N was not "secured by an otherwise unavoidable security interest", and D&N was not otherwise paid for the work.

The next issue is determining the amount of subsequent new value. D&N would likely argue that the amount of new value equaled or exceeded the amount of fees and costs incurred pre-petition. However, § 547(c)(4) mandates that "subsequent advance for new value" exception applies to new value given after the preferential transfer. D&N received $2,000 on July 1, 1999, and $25,000 on July 29, 1999. During the time after the first payment and before the second payment, D&N advanced expenses totaling $66.50 and billed 47.5 hours which, at $150 per hour, totals $7,125. Thus, under § 547(c)(4), the "subsequent advance for new value" exception applies to the $2,000 fee paid on July 1, 1999. Between the time of the $25,000 payment and the petition date, D&N advanced expenses totaling $50.00 and billed 53.75 hours which, at $150 per hour, totals $8,062.50. Accordingly, the most D&N would be entitled to retain from the $25,000 payment would be $8,112.50.

The Court has examined the fee itemization of D&N and, based upon all of the evidence presented, finds that D&N is entitled to retain $2,000 from the first preferential transfer and $8,112.50

from the second preferential transfer, or $10,112.50 in the aggregate.

For all of the foregoing reasons, the Court concludes that D&N received preferential transfers totaling $27,000 pursuant to 11 U.S.C. § 547(b), but that D&N extended subsequent new value of $10,112.50 to Debtor pursuant to 11 U.S.C. § 547(c)(4). Therefore, after the two preferential transfers are considered and credit is given for subsequent new value extended, D&N has received an avoidable preference in the amount of $16,887.50.

This Opinion is to serve as Findings of Fact and Conclusions of Law pursuant to Rule 7052 of the Rules of Bankruptcy Procedure.

See written Order.

ENTERED: August 1, 2000

____

LARRY LESSEN
UNITED STATES BANKRUPTCY JUDGE

c: Jeffrey D. Richardson
P.O. Box 1664
Decatur, IL 62525

David C. Nelson
P.O. Box 649
Mattoon, IL 61938

Rodney L. Smith
622 Jackson Avenue
Charleston, IL 61920

U.S. Trustee
401 Main St. #1100
Peoria, IL 61602

CERTIFICATION OF MAILING

The undersigned, deputy clerk of the United States Bankruptcy Court, hereby certifies that a copy of this Opinion was mailed this date to the parties listed herein.

Dated: August 1, 2000 ___________________________________

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF ILLINOIS

In Re HENNINGS FEED AND CROP CARE, INC., Debtor.	)	In Bankruptcy Case No. 99-72801
ROGER W. STONE, Trustee, Plaintiff, v. DILSAVER & NELSON, Defendant.	)	Adversary No. 00-7002

ORDER

For the reasons set forth in an Opinion entered this day, Defendant Dilsaver & Nelson be and is hereby ordered to turn over to the Trustee the sum of $16,887.50 within thirty days of the date of this Order.

It is further ordered that Defendant Dilsaver & Nelson be and is hereby given 30 days from the date of this Order to file its unsecured claim in this case.

ENTERED: August 1, 2000

____
LARRY LESSEN
UNITED STATES BANKRUPTCY JUDGE

c: Jeffrey D. Richardson
P.O. Box 1664
Decatur, IL 62525

David C. Nelson
P.O. Box 649
Mattoon, IL 61938

Rodney L. Smith
622 Jackson Avenue
Charleston, IL 61920

U.S. Trustee
401 Main St. #1100
Peoria, IL 61602

CERTIFICATION OF MAILING

The undersigned, deputy clerk of the United States Bankruptcy Court, hereby certifies that a copy of this Order was mailed this date to the parties listed herein.

Dated: August 1, 2000 ___________________________________